

NO. 50090-6

COURT OF APPEALS, DIVISION II
OF THE STATE OF WASHINGTON

PUGET SOUND GROUP, LLC et al.,

Appellants,

v.

WASHINGTON STATE LIQUOR AND CANNABIS BOARD,

Respondent.

RESPONDENT'S BRIEF

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I. INTRODUCTION

This case involves judicial review under the Administrative Procedure Act (APA), chapter 34.05 RCW. The Appellants appeal from dismissal of their challenges to two actions of the Liquor and Cannabis Board (Board).

First, they bring a rulemaking challenge to the emergency adoption of WAC 314-55-020(3) by the Board. The Appellants argue that the Board exceeded its statutory mandate under former RCW 69.50.331¹ by failing to adopt a two-step priority system to award additional retail marijuana licenses required by the passage of the Cannabis Patient Protection Act (CPPA). To the contrary, the Board adopted verbatim the legislative mandated competitive, merit based system for additional retail marijuana licenses required by former RCW 69.50.331 to accommodate the consolidation of the recreational and medical marijuana markets.

Second, this case involves a challenge to the Board's decision-making process to increase the total number of retail licenses. The Board's decision was grounded in scientific research as to the size of the medical market, and was not arbitrary and capricious. And, as the determination of the number of retail stores is not a rule under

¹ Effective July 23, 2017, the Legislature removed the competitive, merit-based application process it created as the Board was no longer accepting applications for retail licenses. See RCW 69.50.331; Final Bill Report ESSB 5131.

RCW 34.05.010(16), an increase in that number need not be adopted in rule.

The Puget Sound Group² failed to demonstrate any substantive or procedural defects under the Administrative Procedure Act to the Liquor and Cannabis Board's actions.

This Court should affirm the trial court's dismissal.

II. RESTATEMENT OF ISSUES PERTAINING TO ASSIGNMENTS OF ERROR

1. Whether the Puget Sound Group has met their burden to prove that the Board's emergency adoption of WAC 314-55-020 exceeded its statutory mandates when the Board adopted the legislative mandated criteria?
2. Whether the Puget Sound Group has met their burden to prove that the Board acted arbitrarily and capriciously in the Board's emergency adoption of WAC 314-55-020 where it followed all procedural requirements for rulemaking?
3. Whether the Board was required to engage in rulemaking to exercise its statutory mandate to increase the number of retail marijuana licenses to serve medical marijuana patients?

² There were seven plaintiffs below: The Puget Sound Group, the Cloner's Market, KF Industries, Cannabis Care Collective LLC, SGSG and the Joint LLC. They will collectively be referred to as the Puget Sound Group.

4. Whether the Board's actions were arbitrary and capricious when it relied on the BOTECH study and other information to meet its statutory mandate to increase the number of retail marijuana licenses to accommodate the needs of medical marijuana patients?

III. STATEMENT OF THE CASE

A. Adoption Of The Cannabis Patient Protection Act

In 1998, Washington voters approved Initiative 692 which permitted the use of marijuana for medical purposes by qualifying patients. The Legislature amended Initiative 692 several times after passage, changing who may authorize the medical use of marijuana, the definition of terminal or debilitating medical condition, what constituted a 60-day supply of medical marijuana, and allowing qualifying patients and designated providers to participate in collective gardens. However, prior to 2015, neither Initiative 692 nor the Legislature provided any state agency with regulatory oversight of medical marijuana providers. Likewise, there were no statutory licensing or production standards for medical marijuana nor provisions for taxation of medical marijuana. CP 449 – 453.

In 2012, Washington voters approved Initiative 502 and established a regulatory system for the production, processing and distribution of limited amounts of marijuana for recreational use by adults.

The then-named Liquor Control Board was tasked with licensing and regulating these marijuana producers, processors and retailers, and successfully did so. CP 449-453. The Board used a lottery system to award 334 retail licenses under Initiative 502.

In 2015, the Legislature passed, and the Governor approved, the Cannabis Patient Protection Act. Laws of 2015, ch. 70. One intent of the CPPA was “to adopt a comprehensive act that uses the regulations in place for the recreational market to provide regulation for the medical use of marijuana.” Laws of 2015, ch. 70, § 2. As part of the regulation of medical marijuana, the CPPA established a medical marijuana endorsement to a marijuana retail license that permitted a marijuana retailer to sell marijuana for medical use to qualifying patients and designated providers. RCW 69.50.375(1).

The CPPA also directed the Board to reopen the license period for retail stores and to allow additional licenses to be issued to address the needs of the medical market. The CPPA required the Board to use a “competitive, merit-based” process to consider the applications it received, prioritizing those applicants who could establish experience in the marijuana industry and a history of paying applicable state taxes. Former RCW 69.50.331(1)(a). The CPPA specified the factors related to

an applicant's experience in the marijuana industry that entitled an applicant to one of three priority categories. *Id.*

Additionally, the CPPA directed the Board to reconsider and increase the maximum number of retail outlets it established under Initiative Measure 502, and to allow a greater number of retail outlets to accommodate the medical needs of qualifying patients and designated providers. RCW 69.50.345(2)(d). The CPPA granted the Board discretion in determining the actual size of the increase, describing the factors the Board was to consider and requiring consultation with the Office of Financial Management. *Id.*

The CPPA made the integration of the medical and non-medical market, and elimination of former statutes authorizing "collective gardens" (the term often given to former medical marijuana dispensaries), effective July 1, 2016. CP 453.

B. The Board's Implementation Of The CPPA

1. Adoption of emergency rules.³

On July 15, 2015, the Board filed a Preproposal Statement of Inquiry regarding possible permanent new rules and revisions to current rules to implement 2015 legislative changes.

³ Only the emergency rules are at issue here; Petitioners failed to amend their complaint to include the permanent rules, and the permanent rulemaking file was not before the trial court.

See also, WSR 15-15-092, AR 20. The Board's goal was to ensure service to medical marijuana patients by July 1, 2016. *Id.*

The Board subsequently determined that emergency rules—temporary rules authorized by the APA—would be needed to allow licensing to move forward with the additional licenses mandated as part of the CPPA. Emergency rules were necessary because the permanent rules would not be effective until at least January 2, 2016, but the Board anticipated accepting applications starting on October 12, 2015. AR 21, 22. Staff drafted the proposed emergency rules taking into consideration the requirements of the CPPA. CP 39. The proposed emergency rule creating the system to distribute additional retail licenses mirrored the priority system set up by the Legislature.

At the September 23, 2015 Board meeting, the Agency Rules Coordinator, Karen McCall, made a presentation to the Board regarding the possible adoption of emergency rules. AR 20. In that presentation, Ms. McCall explained that adoption of emergency rules was necessary to implement the CPPA and to ensure that medical marijuana would be available to patients after the closure of collective gardens in July 2016. AR 20. Several documents were also presented to the Board to assist in understanding and deciding whether to approve the adoption of the emergency rules. One of those documents was an Issue Paper regarding

the Emergency Rules for Marijuana. AR 4-5. The Issue Paper described the issue, why rulemaking was necessary, the process for adoption and the proposed changes. AR 4. Also attached was an interlineated copy of those proposed changes. AR 6-18.

During the same meeting, the Board also considered and approved filing a CR-102, the Original Notice of Permanent Rulemaking, for the proposed permanent rules to implement CPPA. The Agency Rules Coordinator again presented the matter to the Board and provided documents including an Issue Paper, an interlineating copy of the proposed rules and a Small Business Economic Impact Statement.

Rebecca Smith, Director of the Licensing and Regulation Division of the Board, gave a brief update regarding the marijuana program at the September 23, 2015 Board meeting. AR 20. Ms. Smith indicated that additional retail applications would be accepted starting October 12, 2015, and there would be three different priorities as required by the CPPA. *Id.* Ms. Smith also indicated that letters would be sent to local authorities alerting them that the limit on retail licenses would be increased. *Id.*

The Board adopted the emergency rules at the meeting and the agency filed them with the Code Reviser on September 23, 2015. AR 3. The emergency rules became effective on that same day. AR 26.

The Board also approved the filing of the CR-102 for the permanent rules.

AR 21-22

The Board continued to work on its permanent rules, and adopted them on May 18, 2016, with an effective date of June 18, 2016. WSR 16-11-110. Prior to the effective date of the permanent rules, the Board adopted the identical emergency rules twice more; once on January 6, 2016, and again on April 6, 2016. WSR 16-03-001; WSR 16-08-123.

2. Increasing the retail marijuana cap.

To assist it in determining how many additional licenses were needed to accommodate the medical market, the Board engaged consulting firm BOTECH to estimate the size (in dollars) of what it called the “transactional medical cannabis sector”⁴ and to estimate that sector’s share of the overall medical marijuana market. CP 681. BOTECH was the same consultant the Board used to assist it in determining the number of retail licenses to grant to implement the recreational market under Initiative 502. CP 38.

BOTECH provided a first draft of the report to the Board staff on November 19, 2015. Board staff expressed some concerns regarding the

⁴ The transactional medical cannabis sector is described as dispensaries or collective gardens that supply marijuana to those who have a medical recommendation. The description “transactional” recognizes how medical marijuana was obtained from these businesses based on a contribution.

report, including the much lower estimate of the number of dispensaries in Washington, the failure to estimate the amount of product leaving dispensaries, and the failure to estimate the number of patients. CP 38-39; CP 682. Board staff also raised a concern that using a dollar amount for market size undervalued the market because dispensaries provided free or reduced priced cannabis. CP 509-511. The Board staff shared their concerns with BOTECH and requested that these concerns be addressed in BOTECH's final report. CP 38. BOTECH then explained that the number of dispensaries were lower than expected because this was the first attempt to count only still-active medical marijuana stores, as compared to simply using a Department of Revenue list which included dispensaries and/or collective gardens that were no longer in business. CP 676. BOTECH also explained to the Board staff that it was impossible to obtain reliable data on the amount of medical marijuana sold by unlicensed, unregulated medical outlets due to the reluctance of such outlets' owners and staff to provide information. CP 38. BOTECH also informed Board staff that the dollar value of revenue is a well-accepted measure of the size of the market, and that other measures such as the number of patients or volume of marijuana leaving medical facilities were problematic to measure. CP 674.

As a result of these discussions, when the final report was received on December 15, 2016, Board staff were satisfied with the report and were able to rely upon it, along with other information, to help them determine the number of additional licenses necessary. CP 39.

In addition to the BOTECH report, the Board staff consulted with the Office of Financial Management and considered its own resources to safely manage the number of retail outlets. CP 39; CP 49.

At the December 16, 2016 Board meeting, Board staff presented their recommendation on the number of new retail licenses to accommodate the medical marijuana market, providing their methodology regarding the distribution of the new retail licenses. A copy of the written description of the methodology used to determine the number of licenses to grant was provided at the December 16, 2016 Board meeting. CP 41-49. The Board adopted staff's recommendation and increased the cap by two hundred and twenty two new retail licenses to a total of five hundred and fifty-six retail licenses.

On January 16, 2016, the Board filed a supplemental notice of rulemaking that proposed amending WAC 314-55-08, 1 among other rule-making proposals. WSR 16-02-128. The proposed amendment to WAC 314-55-081 included the methodology the Board was using to

determine the number of overall retail licenses. *Id.* WAC 314-55-081 was adopted as a permanent rule on May 18, 2016. WSR 16-11-110.

C. Procedural History

On January 29, 2016, the Puget Sound Group filed a Complaint for Declaratory Relief, Injunctive Relief and Writ of Mandamus in Thurston County Superior Court. CP 486-669. In their Complaint, Puget Sound Group alleged and asked for declaratory judgment that the Board:

- Violated WAC 314-55-020(3) by failing to rank within priority by date of submission;
- Acted arbitrarily and capriciously in determining the number of retail cannabis outlets needed to accommodate the needs of qualifying medical cannabis patients;
- Acted arbitrarily and capriciously and contravened its own announced methodology in allocating the capped number of retail cannabis outlets to localities, particularly Seattle;
- Acted arbitrarily and capriciously and in contravention of the CPPA in failing to develop a competitive, merit-based process for evaluating applications for retail cannabis licenses;
- Acted arbitrarily and capriciously and in contravention of the CPPA in failing to permit applicants to demonstrate their experience and qualifications as required by the Ace, and;
- Acted arbitrarily and capriciously and in contravention of the CPPA by requiring retail applicants to have a zero state tax balance.

The Puget Sound Group also requested that an injunction be issued to restrain the Board from using its current prioritization system, and to require that the Board create a new priority system which consists of four

categories of applicants, and then to rank them according to priority criteria and then within each priority by application submission date. In February, 2016, the Puget Sound Group moved to amend their Complaint to add two additional plaintiffs and to add a standard of review to their Complaint. The Amended Complaint was filed in May, 2016. CP 117-150. Like the original Complaint, the Amended Complaint did not challenge the ongoing permanent rulemaking for WAC 314-55-020, nor was it subsequently amended to challenge the permanent rule after it was adopted. *Id.*

On February 12, 2016, the Court denied the Puget Sound Group's Motion for Preliminary Injunction. CP 483. The Board moved for summary judgment and, on July 15, 2016, the Court dismissed all claims, except two: a facial rulemaking challenge, and a challenge to the Board's decision-making process with respect to the number of retail licenses to grant.⁵ VRP 49, Nov. 18, 2016. On November 18, 2016, the Court dismissed the remaining two claims concluding that the Board acted lawfully in its rulemaking and in its decision to increase the number of retail licenses to grant, WAC 314-55-020(3) was consistent with the Board's statutory authority, the decision regarding the number of retail

⁵ The Puget Sound Group did not appeal nor did it assign error to any of the claims dismissed on July 15, 2016. These issues are not before this Court.

licenses to grant was not a significant legislative rule, and that the Board did not act arbitrarily or capriciously in its rulemaking decisions or in the specific decision on the number of retail licenses to grant. VRP 49-51, Nov. 18, 2016; CP 484.

IV. STANDARD OF REVIEW

A. Standard Of Review For The Rulemaking Challenge

Appellants ask this Court to review the validity of the emergency rules adopted regarding the priority system. Appellants' Brief at 12 -26. In reviewing the validity of agency rules, the appellate court conducts the same review as the superior court, reviewing the agency's action and not the superior court's decision. *Franz v. Employment Security*, 43 Wn. App. 753, 719 P.2d 597 (1986). The party challenging the rule, here the Puget Sound Group, has the burden of demonstrating the Board's rulemaking is invalid. RCW 34.05.570(1)(a). The party attacking the validity of the rule must present compelling reasons why the rule is in conflict with the intent and purpose of the statute being implemented. *Hi-Starr, Inc. v. Liquor Control Bd.*, 106 Wn.2d 455, 459, 722 P.2d 808 (1986). Judicial relief is available only if the challengers can also establish that they have been substantially prejudiced by the actions they challenge. RCW 34.05.570(1)(d). *Densley v. Dept. of Ret. Sys.*, 162 Wn.2d 210, 226, 173 P.3d 885 (2007).

RCW 34.05.570(2)(c) provides the standard for judicial review of agency rules:

In a proceeding involving review of a rule, the court shall declare the rule invalid only if it finds that: The rule violates constitutional provisions; the rule exceeds the statutory authority of the agency; the rule was adopted without compliance with statutory rule-making procedures; or the rule is arbitrary and capricious.

Here, the Puget Sound Group claims that the adopted emergency rule exceeded the statutory authority of the agency because it conflicted with the stated purpose of RCW 69.50.331, and was arbitrary and capricious because the agency did not properly consider the rule prior to adoption.

A court must presume that a duly enacted rule is valid, and the court will uphold the rule if it is reasonably consistent with the statute it implements. *E.g. Wash. Pub. Ports Ass'n v. State, Dep't of Rev.*, 148 Wn.2d 637, 646, 62 P.3d 462 (2003); RCW 34.05.570(1)(a). The wisdom or desirability of a rule is not relevant. *St. Francis Extended Health Care v. DSHS*, 115 Wn.2d 690, 702, 801 P.2d 212 (1990), citing *American Network, Inc. v. Utils. & Transp. Comm'n*, 113 Wn.2d 59, 71, 776 P.2d 950 (1989).

A court may invalidate a rule if it is "arbitrary and capricious." RCW 34.05.570(2)(c). The arbitrary and capricious standard for rule review is the same as the standard for review of agency orders: whether

the agency action was willful and unreasoning and taken without regard to attending facts and circumstances. *Wash. Indep. Tel. Ass'n v. Wash. Utils. & Transp. Comm'n*, 148 Wn.2d 887, 903-05, 64 P.3d 606 (2003). This standard accords a great degree of deference to agency decision-making and requires courts to uphold a rule even if it disagrees with the agency's policy choice. *Id.* Thus, the arbitrary and capricious standard allows for significant differences of opinion; a rule will not be invalidated as arbitrary and capricious simply because different decision-makers could reach different conclusions about the need for a rule. *Rios v. Labor & Indus.*, 145 Wn.2d 483, 501, 504, 39 P.3d 961 (2002).

Under this standard, WAC 314-55-020 should be upheld.

B. Standard Of Review For Other Agency Action

The Puget Sound Group also challenges the Board's action to increase the number of retail marijuana licenses available as directed by the CPPA, alleging that the Board failed to adopt the increase in rule and that adoption of the increase, whether by rule or otherwise, was arbitrary and capricious. RCW 69.50.342, Appellants' Brief at 27. These allegations do not seek to invalidate a rule, but instead ask for review of "other agency action," under RCW 34.05.570(4). The scope of review for "other agency action" is very limited. The Court may grant relief only if it determines that the action is: unconstitutional; outside the statutory

authority of the agency or the authority conferred by a provision of law; arbitrary and capricious; or taken by persons who were not properly constituted as agency officials lawfully entitled to take such action. RCW 34.05.470(4)(c).

Under this standard, the Board's action to increase the number of retail marijuana licenses available should be upheld.

C. The Board Is Entitled To Deference

The Puget Sound Group specifically challenges whether the Board is entitled to any judicial deference, alleging that the Board had no applicable expertise in regulating medical marijuana when it adopted the rule in question, or when it decided the number of increased retail licenses, so no deference is due. *See* Appellants' Brief at 10. The Puget Sound Group's assertion is meritless. Their assertion is neither a correct statement of the standard nor its proper application. The Board's interpretation of a statute it is charged with implementing and enforcing is entitled to appropriate deference by a reviewing court. *Pub. Util. Dist. No. 1 of Pend Oreille County v. Dept. of Ecology*, 146 Wn.2d 778, 790, 51 P.3d 744 (2002). Deference to an agency's interpretation of its own regulations is also appropriate. *Postema v. Pollution Control Hr'gs Bd.*, 142 Wn.2d 68, 86, 11 P.3d 726 (2000). Further, the Board has regulated marijuana for a number of years, and the Legislature specifically sought to

combine the medical and non-medical use of marijuana for regulatory purposes in the CPPA. Thus, the Board has acquired valuable experience and expertise, and its interpretations are entitled to due deference.

V. ARGUMENT

A. Emergency Rule WAC 314-55-020 Did Not Exceed The WSLCB's Authority And Was Not Arbitrary Or Capricious

1. The Board's regulations are consistent with the rule-making authority found in RCW 69.50.331.

The Puget Sound Group alleges that emergency rule WAC 314-55-020 regarding the priority system should be found invalid because the rule conflicted with the stated purpose and language of the CPPA, and therefore, exceeded the Board's authority. In particular, the Puget Sound Group claims that former RCW 69.50.331(1)(a) required not just that marijuana applications be prioritized under the statutory criteria, but that the Board was required to adopt a separate and additional competitive, merit-based evaluation. The Puget Sound Group's argument fails because, under the plain reading of the statute, the Legislature required only a single competitive system that prioritized the applicants using the specified experience and qualifications. The plain language of former RCW 69.50.331 did not require a two-step application as suggested by the Puget Sound Group. Therefore, because the rule language directly

mirrors the competitive, merit based application process contained in former RCW 69.50.331, the challenge to the rule should be rejected.

The fundamental objective of statutory construction is to ascertain and carry out the intent of the Legislature. *Bellevue Fire Fighters Local 1604 v. Bellevue*, 100 Wn.2d 748, 751, 675 P.2d 592 (1984), cert. denied, 471 U.S. 1015 (1985). Where statutory language is plain and unambiguous, the statute's meaning must be derived from the wording of the statute itself. *Bellevue Fire Fighters*, 100 Wn.2d at 750. Where the legislative intent does not clearly appear on the face of the statutory language, in order to determine intent, the court may resort to various tools of statutory construction which may include consideration of the legislative history and administrative interpretation of the statute. *State Department of Transp. v. State Employees' Ins. Bd.*, 97 Wn.2d 454, 458-59, 645 P.2d 1076 (1982) (citations omitted). However, the interpretation adopted should always be one which best advances the legislative purpose. *Id.* Where an agency is charged with the administration and enforcement of a statute and the statute is ambiguous, the agency's interpretation of the statute is accorded great weight in determining legislative intent. *City of Seattle v. State Dep't of Labor & Indus.*, 136 Wn.2d 693, 704, 965 P.2d 619 (1998). Finally, the court must

avoid a literal reading of a statute if it would result in unlikely, absurd, or strained consequences. *Id.* at 697.

Former RCW 69.50.331 directed the Board to use a “competitive, merit-based application process that includes, at a minimum, the opportunity for an applicant to demonstrate experience and qualifications in the marijuana industry.” Former RCW 69.50.331(1)(a). The very next sentence directs the Board to give preference to applicants “that have the following experience and qualifications, in the following order of priority. . .” Former RCW 69.50.331(1)(a). Former RCW 69.50.331(1)(a) then goes on to list three priority categories and what experience and qualifications are necessary for each level. Neither former RCW 69.50.331, nor any other provision in the CPPA provided further direction regarding the competitive-merit based process.

Thus, the listed statutory priorities and the qualifications contained in former RCW 69.50.331 are the means by which the Legislature directed the Board to competitively evaluate applications and the means by which applicants are to demonstrate their relevant expertise and experience. Evaluating applicants based upon those statutory priorities is therefore consistent with providing a “competitive, merit-based application process” under the statute.

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Moreover, the Board added additional requirements for applicants to demonstrate their experience and qualifications. WAC 314-55-020 required applicants to demonstrate their ability to successfully operate a retail marijuana business by submitting an operating plan, by submitting documentation of an ability to comply with the traceability system by which legal marijuana is tracked throughout its growing process through sale, and by showing they have the required funds to start and operate their business. WAC 314-55-020(7), (11), and (12). The more prepared and experienced an applicant was, the more rapidly it was generally able to fulfill these licensing requirements. CP 35-37.

Ignoring the plain reading of former RCW 69.50.331, the Puget Sound Group pulls isolated language from the statute. They claim that applicants who were currently operating marijuana “stores” as dispensaries were required to be licensed ahead of others and that therefore, the Board’s rule was not based upon consideration of the facts and circumstances. Appellants’ Brief at 14. This argument incorrectly construes the statute and falls far short of the requirement that a rule was unlawful, unconstitutional or outside an agency’s legal authority.

In particular, the Puget Sound Group misconstrues the statutory language regarding a competitive, merit-based process. They claim it should be interpreted as a statutory direction to use something else or

something in addition to the priority categories listed. The statute, however, does not support their claim. The language in the CPPA directed the Board to use the priority category system instead of the lottery process it previously used to allocate the limited retail licenses mandated under Initiative 502. The language in former RCW 69.50.331(1)(a) simply indicated the nature of the process the Legislature established during this open licensing period. This language evinced Legislative intent to use a system different than the one used previously; instead of a lottery, the Legislature desired a competitive, merit based system. Former RCW 69.50.331(1)(a) then goes on to direct the Board in detail how to determine the relative merit of the competing applications – those demonstrating priority 1 would be processed before priority 2, which would be processed before priority 3. The requirements for the three priority categories are experience and qualifications in the marijuana industry. Former RCW 69.50.331(1)(a)(i)-(iii).

Contrary to the Puget Sound Group's argument, the statutory language does not indicate that the priorities were only to be used when competing applications had the same kind of merit based upon some other competitive process. To the contrary, the statute directs all competing applications are to be given preference based upon the experience and qualifications set out in the priorities. Former RCW 69.50.331(1)(a).

Thus, the Puget Sound Group's preferred process would have been an incorrect implementation of the statute and would lead to a myriad of super-priority 1 applications, with no ability to rank or otherwise distinguish between those priority 1 applications assigned in each category.

There is no merit to the Puget Sound Group's claim that the Board's interpretation makes the statutory language regarding "competitive, merit-based process" superfluous. The Board interpretation implemented that statute by ensuring that the priority system is the competitive, merit based process dictated by that statute.

To the extent Puget Sound Group alleges that the Legislature intended some competitive process in addition to the priorities specified in the statute, no legislative history supports that claim. *See* CP 433-459. None of these analyses of the CPPA suggests that the Legislature intended a process in addition to the priorities specified in the legislation. For example, in the House Health Care & Wellness Committee Bill Analysis, the next to last paragraph states:

"The LCB's licensing process for marijuana producer, processor, and retailer licenses must be comprehensive, fair, and impartial evaluations of applications. The LCB must develop a competitive, merit-based application process that allows applicants to demonstrate experience and qualifications in the marijuana industry, including

operating a collective garden, having a business license,
and remitting sales tax.”

CP 435. Those factors are the same factors used in the first two of the priority categories, and there is no reference in this House Bill analysis to any other kind of application process to be used to evaluate applicant experience. *See* CP 433- 439.

The Senate Bill Report likewise supports the interpretation that the statutory priorities are the means by which applicants are to demonstrate and receive credit for prior experience in medical marijuana dispensaries, including credit for possessing business licenses and paying sales tax. The top paragraph on page 5 of that report, under the heading “Effect of Changes Made by Health-Care Committee,” states “LCB must develop a merit-based license system that takes into account experience of people running dispensaries and allow credit for those businesses that have business licenses and pay sales tax.” CP 444. The statutory language specifying the three priority categories does exactly that, and the Board adopted those statutory priorities into its regulation verbatim. If the Legislature intended some additional means of giving additional credit for those currently operating a medical marijuana business, or for those operating in the jurisdiction where they applied, there is nothing in the statute or the legislative history to indicate that intent.

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The Final Bill Report demonstrates this legislative intent even more clearly. On page 3 of that report, in the second paragraph, is the following language:

LCB must reopen the license period for retail stores and allow for additional licenses to be issued to address the needs of the medical market. LCB must establish a merit based system for issuing retail licenses. First priority must be given to applicants that have applied for a marijuana retailer license before July 1, 2014, and who have operated or been employed by a collective garden before November 6, 2012, and second priority to applicants who were operating or employed by a collective garden before November 6, 2012 but who have not previously applied for a marijuana license.

CP 451. That report language directly quotes the statutory priorities established by the CPPA; and, again, the Board adopted those priorities into the emergency regulation verbatim. Again, this shows that the Puget Sound Group's arguments have no sound basis in the statutory language or history.

The Puget Sound Group sidesteps this by arguing broadly that the Board did not carry out its own "purpose" in adopting WAC 314-55-020. Appellants' Brief at 14-15. It claims that by forcing existing providers to compete with some other applicants, the Board did not ensure that "medical marijuana will be available to patients by . . . July, 2016." It supports this argument with references (not cited to anything in the administrative record) to the way the Board processed applications, and not to the Board's rules. This argument should be rejected. The purpose

statement cited is the basis for needing to adopt emergency rules so that the licensing process would result in sufficient licensed outlets to serve patients by July, 2016, when unlicensed outlets shut down. Nothing in this record shows that purpose was not served. More to the point, nothing about that general purpose prevented the Board from adopting the rules consistent with the statutory directives.

Contrary to the Puget Sound Group's repeated claims, there is nothing in the statute or the legislative history to support an argument that some different, additional competitive process in addition to the priorities was intended or required. The failure to include such an additional process does not demonstrate that the Board's rule is arbitrary or capricious or that it conflicts with the statute. To the contrary, the Board's rule much more closely implements the language of the statute than the Puget Sound Group's alternative formulation of what the rule should have been.

B. The Board Was Not Arbitrary And Capricious In The Emergency Adoption Of WAC 314-55-020

The Puget Sound Group argues that the Board did not act with "due" deliberation or adopted the regulations without sufficient "consideration" and thus acted arbitrarily and capriciously. Appellants' Brief at page 11-12. This argument is meritless.

An agency action is arbitrary and capricious if it is willful and unreasoning and taken without regard to the attending facts or circumstances. *Rios*, 145 Wn.2d at 501, 39 P.3d 961. If there is room for two or more opinions, an agency is required to take due consideration of the alternatives. *Id.* This examination of agency action is consistent with the APA's requirement that "[i]n reviewing matters within agency discretion, the court shall limit its function to assuring that the agency has exercised its discretion in accordance with law, and shall not itself undertake to exercise the discretion that the Legislature has placed in the agency." RCW 34.05.574(1).

In arguing that the Board's emergency adoption of WAC 314-55-020 was arbitrary and capricious, the Puget Sound Group merely assumes that there was no deliberation, discussion, or consideration. They point to the agenda and the length of the meeting to support their baseless assumption. Even if their speculation of a short deliberation could be shown in this case, Appellants provide no legal argument supporting what is a sufficient amount of time or "consideration" that is required during the rulemaking process. Similarly, they offer no legal argument supporting the specific amount of deliberation required. These are not reasons for a reviewing court to invalidate an agency rule.

Moreover, contrary to the Puget Sound Group's assertion about multiple interpretations of former RCW 69.50.020 that apparently warranted some sort of debate, the reasonable interpretation of that statute is set forth above. There was no need for the Board to discuss or deliberate between multiple alternatives. And as the rule adopted the statutory criteria as laid out in former RCW 69.50.020, the Board's decision to adopt WAC 314-55-020 cannot be labeled as action without due consideration and cannot be arbitrary and capricious based on the adoption meeting itself.

The Puget Sound Group notes that the Board's rule-making file omitted all comments received, petitions for amendments, and citations to the data and information relied upon. Appellants' Brief at 17. This argument is misdirected. Their rulemaking challenge, however, was solely to the emergency adoption of WAC 314-55-020 and not to the permanent rules which were later adopted on May 18, 2016. Those items which the Puget Sound Group points out were missing in the rulemaking file were not required for the adoption of the emergency rule. RCW 34.05.350(1)(a) (describing authority to adopt emergency rules). Those items would have been part of the permanent rulemaking file which was developed after the adoption of the emergency rule. *See* RCW 34.05.370.

Despite the fact that the Puget Sound Group did not challenge the permanent rules, they also argue that the Board did not follow required rulemaking procedures to convert its initial emergency rules to permanent rules, using only the lack of documents in the emergency rulemaking file as support. Appellants' Brief at 16. Again, this argument goes beyond the petition below, which did not seek to invalidate the permanent rule, and also lacks merit. The Puget Sound Group's Complaint and its Amended Complaint sought a declaratory judgment against the emergency rules only and not the permanent rules. CP 486-669; 117-150. Thus, the only rulemaking file certified in the litigation was the emergency rulemaking file. AR 1 - 39. Had the Puget Sound Group intended to challenge the adoption of the permanent rule, it should have amended its Complaint and requested that the permanent rulemaking file be certified.

Moreover, the Board followed all required rulemaking procedures, including those required for adopting permanent rules after first promulgating emergency rules. The Board's Washington State Register filing confirms the Board fully complied with those requirements, which direct an agency to provide for public input and demonstrate consideration. WSR 16-07-154, filed March 23, 2016. The Puget Sound Group cites no specific requirement with which the Board failed to comply. Simply alleging that the Board could not or did not consider the

rules before it adopted them falls far short of proving any procedural defect in the rulemaking process, or that the Board acted arbitrarily and capriciously. In sum, this claim fails.

C. The Board Reasonably Exercised Its Statutory Mandate To Increase The Number Of Retail Marijuana Licenses To Issue Under The CPPA And Reasonably Relied On BOTEK

1. The Board was not required to engage in rulemaking to increase the number of retail marijuana licenses under the CPPA.

The Puget Sound Group contends that the Board was required to set the increase in the total number of retail licenses in a rule. Appellants' Brief at 37. However, determining the total number of licenses does not meet the definition of a rule under the Administrative Procedures Act, and therefore rulemaking was not required.

Under the APA, a rule is defined, in pertinent part, as:

any agency order, directive, or regulation of general applicability (a) the violation of which subjects a person to a penalty or administrative sanction; (b) which establishes, alters, or revokes any procedure, practice, or requirement relating to agency hearings; (c) which establishes, alters, or revokes any qualification or requirement relating to the enjoyment of benefits or privileges conferred by law; (d) which establishes, alters, or revokes any qualifications or standards for the issuance, suspension, or revocation of licenses to pursue any commercial activity, trade, or profession; or (e) which establishes, alters, or revokes any mandatory standards for any product or material which must be met before distribution or sale. The term includes the amendment or repeal of a prior rule, but does not include (i) statements concerning only the internal

management of an agency and not affecting private rights or procedures available to the public . . .

RCW 34.05.010(16).

The license limit or cap directs Board staff as to the number of retail licenses available to issue in each jurisdiction.⁶ It does not subject any applicant or person to a penalty or sanction. RCW 34.05.010(16)(a). It does not affect any procedure or requirement relating to Board hearings. RCW 34.05.010(16)(b). It does not alter any qualification or standard the applicant must satisfy for the issuance of a license (unlike the addition of the priorities, which the Board did adopt in a rule). RCW 34.05.010(16)(d). In sum, the increase in the numbers of licenses available is not an action that requires rulemaking.

The Board complied with each provision of the statute that directed it to increase the number of available retail marijuana licenses to accommodate the inclusion of medical marijuana in its licensing and regulatory responsibilities. RCW 69.50.345(2).

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⁶ Nor did the Board adopt a rule after passage of Initiative 502 that included the numbers of retail licenses available in each jurisdiction for the initial round of licensing. The Board did adopt a rule, WAC 314-55-081, that explained the methodology used to determine the number of retail licenses available in each jurisdiction and referenced where to find them, and amended it after enactment of the CPPA.

2. The “significant legislative rule” statute does not apply to the board’s policy.

The Puget Sound Group also asserts that in adopting the increased number of licenses, the Board adopted a significant legislative rule without required notice and comment or substantial compliance with required rulemaking procedures. There is simply no basis to assert that the Board’s rules are subject to the requirements of the “significant legislative rule” provisions.

By its own terms, RCW 34.05.328(1) establishes that the Board’s action to adopt the increased number of retail marijuana licenses is not a “significant legislative rule.” RCW 34.05.328(5)(a). Significant legislative rules are only those rules “of the departments of ecology, labor and industries, health, revenue, social and health services, and natural resources, the employment security department, the forest practices board, the office of the insurance commissioner, and the legislative rules of the department of fish and wildlife implementing chapter 77.55.” RCW 34.05.328(5)(i). While this statute can also apply to other agencies’ rules if mandated by the joint administrative rules review committee or if the section is voluntarily made applicable by the agency, the Puget Sound Group has not demonstrated that either of those things occurred.

The Board's adoption of the increased number of retail marijuana licenses to grant in jurisdictions statewide is not a "significant legislative rule" under RCW 34.05.328, and the Puget Sound Group's argument based upon that allegation must fail.

3. The board's use of the BOTEC report was reasonable.

a. The BOTEC report provided reliable and credible data.

In its brief, the Puget Sound Group continues to raise the same objections to the BOTEC report that it raised at the trial court level. To counter these objections below, the Board filed declarations from two imminently qualified experts who had worked on the BOTEC report - Dr. Mark Kleiman and Mr. Steven Davenport. CP 672-736 and CP 737-740, respectively. These declarations successfully rebut every challenge made by the Puget Sound Group to the BOTEC report.

For example, the Puget Sound Group asserts that the Board's objections regarding metrics were not addressed in the final report. The Puget Sound Group also argues that the word "patient" does not appear in the final report and volume of cannabis "out the door" was not addressed. Appellants' Brief at 29. Mr. Davenport, a co-author of the December 2015 BOTEC report and former managing Director of the BOTEC Analysis Corporation, stated in his declaration that BOTEC was

not asked to include an estimate of the number of patients in its report, and did not do so. CP 738. Further, Dr. Kleiman, who co-authored December 2015 BOTEC report, and founded BOTEC Analysis group, stated in his declaration that these alternative measures of the size of the marijuana market (number of patients and volume of marijuana sold) are equally imperfect, if not more so. CP 674-675. Finally Dr. Kleiman stated that “despite its limitations, the dollar value of revenue is a well-accepted measure of the size of the market.” *Id.* Continuing its argument as to the metrics used, the Puget Sound Group also contends that key inputs were not used in the report, arguing that BOTEC disregarded cannabis that may have been donated to medical marijuana patients, and that BOTEC wrote off 25% of the medical market because it did not include sales at farmer’s markets and delivery services. Appellants’ Brief at 29. This contention fails. As Mr. Davenport stated, BOTEC did attempt to measure these types of activities, but was unable to do so as these suppliers are relatively rare to begin with. CP 738. Additionally, the possible impact of these suppliers was much less than originally thought. For example, although the delivery service for medical cannabis was thought to be as much as 25%, it could not be empirically verified. BOTEC did not write off 25% of the medical market, but instead used inputs that were verifiable and significant. *Id.* The Puget Sound Group

also challenges BOTECH's attempt to validate the model, taking aim at figure #13 contained in the report. Appellants' Brief at 31. As Mr. Davenport explained, Puget Sound Group is quite simply wrong: "[F]igure #13 does not display outputs of the model, as implied, but rather it displays inputs to the model. It would not be appropriate, as the plaintiff suggests, for those figures to appear in Figure #19." CP 738-739.

The Puget Sound Group attempts to buttress this attack by stating that "there is no substantive difference between the first and second reports." Appellants' Brief at 31-32. Mr. Davenport, however, stated this assertion "is patently false and is easily refuted. As is clearly documented in each report, BOTECH's point estimates were raised from \$396 million (see exhibit 9 of the draft report) to \$480 million (Figure 19, final report)." CP 739.

The Puget Sound Group goes on to then allege that because of the issues regarding BOTECH, the Board's reliance on the BOTECH report was arbitrary and capricious. This argument also lacks merit. As pointed out above, the data and analysis was performed using commonly used and accepted methods. CP 739-740. In addition, the University of Washington came to very similar conclusions (shortly after the BOTECH study). See CP 740. This further supports both BOTECH's methods and its conclusions.

b. The Board's reliance on BOTEK's report was reasonable.

To be considered arbitrary and capricious, the Board's use of the BOTEK study would need to be considered a willful and unreasoning action taken in disregard of facts and circumstances. *Wash. Indep. Tel. Ass'n v. Wash. Utils. & Transp. Comm'n*, 148 Wn.2d 887, 903-05, 64 P.3d 606 (2003). Clearly it was not. The BOTEK report was well founded and it was reasonable for the Board to rely on it.

The Puget Sound Group also contends, without support, that there was insufficient time between the initial draft of the report, which staff criticized, and the final version the staff accepted for adequate consultation among staff and the Board prior to the Board's vote on the increased number of licenses, which was taken on December 16, 2015. Appellants' Brief at 27-28. The Puget Sound Group then argues this lack of time forced the Board to make the decision without due consideration. This is simply factually incorrect. Staff had been working on the analysis of the BOTEK report since the time it received the initial report in November, as is evidenced by the questions that were raised. Staff continued to work on their recommendation during this time, and were able to finalize it once BOTEK's final report came in. *See* CP 40 – 48.

The Puget Sound Group can point to nothing to support its allegation that the Board did not spend adequate time considering this matter.

Finally, the Puget Sound Group appears to argue that the Board relied solely upon the BOTECH study for the increased number of retail licenses it adopted. Appellants' Brief at 32-35. That argument is factually incorrect. Rather than relying solely upon the BOTECH study, the record establishes that the Board used the BOTECH report, consulted with the Office of Financial Management, and also considered the other factors as directed by the statute, including the fact that there were already existing retail marijuana stores licensed following the passage of Initiative 502, which could also serve the needs of medical patients. *Id.* CP 38-39.

The Puget Sound Group has not established that the Board's adoption of the increased numbers of retail marijuana licenses to be granted in jurisdictions statewide constitutes arbitrary or capricious action.

D. The Puget Sound Group Is Not Entitled To Attorney Fees

The Puget Sound Group argues that if it prevails it is entitled to attorney's fees for its work, both at the superior court level and in this Court under the Equal Access to Justice Act (EAJA) at RCW 4.84.340 - .360. Even if the Puget Sound Group were to prevail in this Court, which it should not, it would not be entitled to attorney's fees.

Fees and other expenses under the EAJA cannot be awarded unless the Court finds the agency action was not “substantially justified.” An agency’s failure to prevail does not create a presumption that its position was not substantially justified. *Kali v. Bowen*, 854 F.2d 329, 332 (9th Cir 1988); RCW 4.84.350(1). Although neither the Washington EAJA, nor the federal EAJA, 28 U.S.C. § 2412, defines the term “substantially justified,” the phrase has been found to mean “justified in substance or in the main” or, in other words, “to a degree that could satisfy a reasonable person.” Gregory Sisk, *Essentials of the Equal Access to Justice Act: Court Awards of Attorney’s Fees for Unreasonable Government Conduct (Part Two)*, 56 La. L. Rev. 1, 18 (1995). See also *Pierce v. Underwood*, 487 U.S. 552, 565, 108 S. Ct. 2541, 101 L. Ed. 2d 490 (1988). “[t]he government must be alerted by plain statutory language or regulatory language or by clear and controlling case precedent before its practices can be assailed or unjustified.” Sisk, 56 La. L. Rev. at 61. In other words, the state’s position need not be correct, only reasonable. *Pierce*, 487 U.S. at 565, *Stuewe v. Dep’t of Rev.*, 98 Wn. App. 947, 991 P.2d 634 (2000). Additional factors suggesting that fees should not be awarded are the existence of conflicting authority or the novelty of the

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question. *Marcus v. Shalala*, 17 F.3d 1033, 1037 (7th Cir. 1994); *Alpine Lakes Protection Society v. Dep't of Natural Res.*, 102 Wn. App. 1, 979 P.2d 929 (1999). The state must have enough of a foundation in law and fact that a reasonable person could think it was correct. 32 Am. Jur. 2d *Federal Courts* § 339. Here, the Puget Sound Group has failed to provide any analysis on the issue of whether the Board was justified in the actions it took. Therefore, its request for attorney fees fails on that basis alone. Further, the fact that the Board prevailed in superior court dictates that the Board's actions were at a minimum, substantially justified.

Even if this Court were to reverse the trial court and find that the Board's actions were not substantially justified, the Puget Sound Group would not be entitled to attorney's fees for superior court work as it was not a prevailing party.

The Board's emergency rulemaking and its cap on the number of licenses were substantially justified and no award of a fee is just.

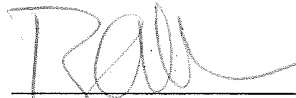
VI. CONCLUSION

The Board properly adopted regulations to implement the CPPA, and the rules' substantive content lawfully carried out the statute's language and intent. The Board used a reasonable, lawful process to increase the number of retail marijuana licenses, as required by the CPPA.

The Puget Sound Group has established no basis for granting judicial relief, and the trial court's dismissal should be affirmed.

RESPECTFULLY SUBMITTED this 13th day of September,
2017.

ROBERT W. FERGUSON
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A handwritten signature in dark ink, appearing to read "Penny L. Allen", is written over a horizontal line.

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